Internal Revenue Service

memorandum

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TS/P/WHBARD/lmr

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to: District Counsel, Baltimore CC:BAL
Att: Mary Corman

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [redacted]
TL-N-5304-91
CC:TL/P Hearo Wilson
Consideration of Partnership NOL Carrybacks in Non-TEFRA Proceeding I.R.C. §§ 6230(d)(6); 6511(g)

This memorandum is in response to your request for tax litigation advice received by this office on March 28, 1991.

ISSUE

1. May potential net operating loss carrybacks from docketed TEFRA years be taken into account in a current docketed non-TEFRA year.

2. What period of limitations controls the timely filing of an amended return containing carrybacks of partnership items.

CONCLUSION

1. Since partnership items may not be considered in the non-TEFRA proceeding, a decision must be entered which ignores the partnership items.

2. The period of limitations for filing a claim for refund or credit attributable to partnership items is contained in I.R.C. § 6230(d) and (c).

FACTS

The [redacted] tax shelter issues in the above-referenced case, and all cases piggybacked to that case, have been decided by the Tax Court. [redacted]

The piggyback agreement in this shelter was structured so that a decision would be entered in each case (approximately [redacted] cases) and will be subject to each petitioner's separate right of appeal. Therefore a Rule 155 computation is required in each docketed case. The respondent has been attempting to secure Rule 155 decisions from the petitioners.

The Government prevailed in the [redacted] case. The petitioners do not want to agree to the Rule 155 computations, however, without settling all the "out years" of [redacted] as well as the other two partnerships, [redacted] and [redacted], where some (but not all) of the [redacted] petitioners were partners. The petitioners wanted the respondent to include language in the non-TEFRA decision which would in effect, create a "generic NOL". That is, petitioners wanted the respondent to state that the deficiency, as decided by the Court can be reduced by any NOL carryback generated in future years. District counsel has refused to put this type of language in the documents.

Furthermore, since no allegations of computational problems had been raised, district counsel has submitted approximately [redacted] of the decisions as unagreed Rule 155 decisions.[1] On [redacted], Judge [redacted] heard arguments from petitioners and respondent regarding the unagreed Rule 155 decisions. At that time district counsel argued that, if the petitioners insist that the NOL carryback be part of the Rule 155 computations, then they would have to plead and prove these NOL carrybacks. The Court agreed, and will permit the petitioners to amend each petition and raise the NOL carrybacks.

The petitioners are insisting that the Court address the NOL's on each decision because they do not want to rely on I.R.C. § 6511(d)(2)(B)(iii). The petitioners are concerned that § 6511 will not allow the NOL's to be carried back because the NOL's from the [redacted] "out years", [redacted], and [redacted], are being generated from TEFRA proceedings. Section 6230(d)(6) states that "Subchapter B of Chapter 66 [which includes I.R.C. § 6511 and other sections relating to limitations on credit or refund] shall not apply to any credit or refund of an overpayment attributable to a partnership item (or an affected item)." The "out years" for [redacted] and [redacted] are before the Tax Court as docketed TEFRA partnership proceedings. [redacted] is still in ninety-day status and therefore comments for that partnership are in effect. The petitioners filed no claims for NOL's within the time limits set out in § 6511(d)(2)(A), except that [redacted] is an extended year for the TEFRA proceeding. [redacted]

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[1] The cases not submitted involve overpayments, increased deficiencies or cannot have a deficiency determined because other tax shelters are still in litigation.

[redacted]

DISCUSSION

A. JURISDICTION

Initially we note that the court lacks jurisdiction in a partner's individual case over partnership items subject to an ongoing TEFRA proceeding. Munro v. Commissioner, 92 T.C. 71 (1989). In Munro, the court held that

> [n]either respondent nor petitioner may . . . raise partnership items in deficiency proceedings.

Id. at 73, citing E.C.F. Energy Partners v. Commissioner, 89 T.C. 741 (1987) and Maxwell v. Commissioner, 87 T.C. 783, 788 (1986). The court quoted the following language from Maxwell:

> It is evident both from the statutory pattern and from the Conference report that Congress intended administrative and judicial resolution of disputes involving partnership items to be separate from and independent of disputes involving nonpartnership items. Consequently, the portion of any deficiency attributable to a "partnership item" cannot be considered in the partner's personal case involving other matters that may affect his income tax liability. The "partnership items" must be separated from the partner's personal case and considered solely in the partnership proceeding.

In Trost v. Commissioner, 95 T.C. -- (1990), petitioners included in their petition of a notice of deficiency a claim that an overpayment existed attributable to their investment in a partnership for the same year as the deficiency notice. The partnership was concurrently the subject of a separate TEFRA proceeding. The court reaffirmed that they had no jurisdiction over partnership items regardless of whether a notice of FPAA is issued before the deficiency proceeding (as in that case) or after the deficiency proceeding has begun (the facts of Maxwell). The court also rejected petitioners allegation that they would be precluded from filing a claim with respect to the overpayment in

District Court under the doctrine of res judicata. The court stated:

> In this regard, however, we note that the doctrine of res judicata only bars a subsequent suit if the claim could have been litigated in a prior case. . . In this case, we do not have jurisdiction to determine an overpayment attributable to partnership items. Therefore, petitioners' concern [is] unwarranted.

I.e., in computing a deficiency in a non-TEFRA case, all partnership items are removed from the computations.[2] When the partnership proceeding is complete, adjustments are made to a partner's ultimate tax liability attributable to the adjustments of partnership items. See I.R.C. §§ 6231(a)(6) and 6225.

Affected items are also assessed subsequent to the TEFRA proceeding. The court in K.C.F. Energy Partners explained how affected items are assessed:

> An item may be an affected item solely because of a computational adjustment that cannot be made until the partnership proceeding is completed. For example, the amount of a medical expense deduction pursuant to section 213(a) depends on the partner's adjusted gross income. The amount of adjusted gross income depends on the partner's share of partnership income or loss. The amount of the medical expense deduction would be, therefore, an affected item. The partnership level proceeding must be completed to compute the partner's adjusted gross income and the amount of the allowable deduction under section 213(a). Respondent in such a case, need not issue a notice of deficiency to the partner because the deficiency determination is merely computational. . . .
>
> In contrast, the other type of affected item requires factual determinations to be made at the partner level. For example, a partner will be liable for the addition to tax for negligence pursuant to

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[2] See CCDM (35)(24)70(5) for the manner in which the Service makes these computations. On occasion, the parties may stipulate that the partnership items as reported will be assumed to be correct for the purposes of a non-TEFRA decision document computation pending the outcome of the TEFRA proceeding. Id. This prevents the taxpayer from being subject to any "tax bracket creep" prior to the final determination of partnership items.

section 6653(a) if he has an underpayment of tax some part of which is due to negligence. The existence of an underpayment of tax at the partner level cannot be made until the partner's share of distributable items of income, deduction and credit is determined in the partnership level proceeding. Once the partnership level proceeding ends, however, the factual question of whether any part of an underpayment due from a partner was due to the partner's negligence must be answered at the partner level. In such instances, unless conceded by the partner, respondent will issue a notice of deficiency for the addition to tax under section 6653(a) to the partner after the completion of the partnership level proceedings. The partner may then file a petition in this Court for a redetermination of that deficiency. The prior partnership level proceeding will be res judicata as to the partnership adjustments, and in subsequent litigation we will decide only whether some part of the underpayment, if any, was due to negligence.

It is our position that a NOL carryback which has been claimed prior to the resolution of the partnership items is a computational affected item. The adjustments would be purely computational. Thus, the NOL will be determined through a computational adjustment after the completion of the partnership proceeding. Cf. Maxwell v. Commissioner, supra (ITC carryback is an affected item). If partnership item deductions are disallowed, then any such excess deductions or credits which were previously carried back will be disallowed through a computational adjustment. By the same token, to the extent losses are increased in the TEFRA proceeding, the carryback amount would also be increased.

It is our view that the same approach is followed when partnership items are settled. When such items are settled, they convert to nonpartnership items. I.R.C. § 6231(b)(1)(C). The settling partners drop out of and are no longer parties to the partnership proceeding. I.R.C. § 6224(d). At this point, arguably, the converted items may no longer fall within the prohibition of Munro that they may not be considered in a non-TEFRA proceeding. They are no longer partnership items and they are no longer subject to a separate partnership proceeding which was the reason for excluding them in the first place from the partner level proceeding.

However, section 6230(a)(2)(A)(ii) provides:

(a) *COORDINATION WITH DEFICIENCY PROCEEDINGS.-*

(1) IN GENERAL.- Except as provided in

> paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.
>
> (2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.-
>
> (A) Subchapter B shall apply to any deficiency attributable to -. . .
>
> (ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) . . . (emphasis supplied)

Thus, settled items are not subject to deficiency procedures or are other converted items. Furthermore, section 6230(c) indicates that settled partnership items should still be subject to a refund procedure provided under TEFRA. Specifically, section 6230(c)(1)(A)(ii) provides that "a partner may file a claim for refund on the grounds that . . . the Secretary erroneously computed any computational adjustment necessary . . . to apply to a partner a settlement."

Thus, it appears that even settled partnership items cannot be determined in a non-TEFRA proceeding. At best, having been previously determined, they could be taken into account for computational purposes only.

B. ADMINISTRATIVE PROVISIONS GOVERNING CARRYBACK OF PARTNERSHIP ITEMS

Of course, whether or not a loss is carried back depends on whether an amended return has been filed for the prior year claiming the carryback as a deduction.

I.R.C. § 172(a) provides in part:

> There shall be allowed as a deduction for the taxable year an amount equal to . . . the net operating loss carrybacks to such year.

That, a net operating loss, including a loss which includes losses from a TEFRA partnership, may be deducted in a year prior to the year in which the loss arose. This is generally done through the filing of an amended return.

Initially, a claim must be consistent with partnership items as determined at the partnership level. I.R.C. § 6221 (partnership items must be determined at partnership level); I.R.C. § 6230(c)(4)(FPAA, final decision of court or settlement, whichever is applicable, may not be challenged). See also N.C.F. Energy Partners, supra (determined partnership items are res judicata in any subsequent proceeding).

If an amended individual return (Form 1040) is filed containing partnership item deductions from a later year (either as reported on the partnership return, as adjusted pursuant to a partnership level proceeding, or as settled) the Service may refund the proper amount taking into account the partnership items as determined at the partnership level. Section 6402[3] provides in this regard:

> **(a) GENERAL RULE.**-In the case of any overpayment, the Secretary, within the applicable period of limitation, may credit the amount of such overpayment, including any interest thereon, against any liability in respect of the internal revenue tax on the part of the person who made the overpayment and . . . refund any balance to such person. (emphasis supplied)

There is no statutory provision governing the existence of amended returns as such. Subchapter E of Chapter 66 of the Internal Revenue Code, however, generally provides limitations upon when such amended returns may be filed. Section 6230(d)(6), however, provides:

> **(6) SUBCHAPTER B OF CHAPTER 66 NOT APPLICABLE**-Subchapter B of chapter 66 (relating to limitations on credit or refund) shall not apply to any credit or refund of an overpayment attributable to a partnership item (or affected item)

Section 6511(g) provides:

> **SPECIAL RULE FOR CLAIMS WITH RESPECT TO PARTNERSHIP ITEMS.**-In the case of any tax

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3 This section is contained in Chapter 65A.

> imposed by subtitle A with respect to any person which is attributable to any partnership item (as defined in section 6231(a)(3)), the provisions of section 6227 and subsection (c) and (d) of section 6230(c) shall apply in lieu of the provisions of this subchapter.

Thus, the limitations upon the filing of an amended return claiming partnership items are provided by sections 6227 and 6230(c) and (d) rather than by subchapter B. Section 6227 generally is no longer applicable once a TEFRA proceeding has begun. I.R.C. § 6228(a)(2)(B) and (b)(2)(C) (Petition with respect to item under section 6227 not permitted after TEFRA proceeding initiated). Thus, sections 6230(c) and (d) provide the limitations if a TEFRA proceeding has been initiated or completed.

Section 6230(d) provides as follows:

> (d) SPECIAL RULES WITH RESPECT TO CREDITS OR REFUNDS ATTRIBUTABLE TO PARTNERSHIP ITEMS.-
>
> (1) IN GENERAL.- Except as otherwise provided in this subsection, no credit or refund of an overpayment attributable to a partnership item (or an affected item) for a partnership taxable year shall be allowed or made to any partner after the expiration of the period of limitation prescribed in section 6229 with respect to such partner for assessment of any tax attributable to such item.
>
> . . .
>
> (3) CLAIMS UNDER SUBSECTION (c).- If a timely claim is filed under subsection (c) for a credit or refund of an overpayment attributable to a partnership item (or affected item), credit or refund of such overpayment may be allowed or made at any time before the expiration of the period specified in section 6532 (relating to periods of limitations on suits) for bringing suit with respect to such claim.
>
> (4) TIMELY SUIT.- Paragraph (1) shall not apply to any credit or refund of any overpayment attributable to a partnership item (or an item affected by such partnership item) if a partner brings a timely suit with

> respect to a timely administrative adjustment request under section 6227 or a timely claim under subsection (c) relating to such overpayment.

Thus, if a partner filed an amended return containing a net operating loss carryback which includes partnership items, the Service will consider the request as long as the period of limitations for issuing the refund attributable to partnership items has not expired. If entitlement to a refund is predicated on the outcome of a TEFRA proceeding, the Service would wait to make any refund or credit until the TEFRA proceeding is complete. At that point a computational adjustment is made to the partner Form 1040 (including amendments) to determine the proper tax liability. The computational adjustment is applied to the year in which the original deduction arose and to any year to which the deduction is carried. See Maxwell v. Commissioner, supra, (NOL carryback is affected item); M.C.F. Energy Partners v. Commissioner, supra (affected item which require no partner level determinations are "computational affected items" which may be directly assessed). See also I.R.C. § 6230(d)(5)(Overpayment may be refunded without requirement that partner file claim).

The statute does not prohibit a refund following the TEFRA [illegible]. Section 6230(c) provides as relevant here:

> (c) CLAIMS ARISING OUT OF ERRONEOUS COMPUTATIONS, ETC.-
>
> (1) IN GENERAL.-A partner may file a claim for refund on the grounds that-
>
> . . .
>
> (B) the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to a partner of a settlement, a final partnership administrative adjustment, or the decision of a court in an action brought under section 6226 or section 6228(a).(emphasis supplied)

Section 6230(c)(2)(B)(iii) provides that a claim under the above provision

> shall be filed within 2 years after . . . the day on which the settlement was entered into [or]. . . the day on which the decision of the court becomes final.

Thus, if petitioners' file or have filed amended returns claiming NOL carrybacks comprised of partnership items, they must await the outcome the TEFRA proceeding with respect to the base years generating the TEFRA losses. Whether they are entitled to a refund or credit will depend upon a final determination of their allocable share of losses at the partnership level. If the Service does not issue a refund or credit which these individuals would be entitled to, after applying the final partnership decision or settlement, they would have two years from the decision in the partnership case (or settlement if applicable) to file a claim for refund under section 6230(c).

If the claim is not allowed or ruled upon, section 6230(c)(3) provides as follows:

> [I]f any portion of [a claim] is not allowed, the partner may bring suit with respect to such portion within the period specified in subsection (a) of section 6532 (relating to periods of limitations on refund suits).

In summary, the court in a non-TEFRA proceeding cannot determine or consider partnership items or computational affected [illegible] partnership items. [illegible] subject to separate procedures governing their determination and any resultant credits or refunds.

In the instant case, petitioners seek a resolution of partnership item carrybacks in their non-TEFRA deficiency proceeding. Alternatively, they wish to stay the present proceeding pending the outcome of the partnership proceeding. Since partnership items may not be considered in the non-TEFRA proceeding, a decision must be entered which ignores the partnership items. As indicated above, however, this will not leave petitioners without a remedy under TEFRA procedures (assuming a TEFRA loss exists which can be carried back).

Please refer any questions on this matter to Bill Heard at FTS 566-4369.

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